

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Table of Contents

Overview.....	2
Introduction.....	2
Policy	3
Authoritative Guidelines.....	3
Lease Transactions to be Submitted to DOA.....	3
What Is <u>Not</u> To Be Submitted.....	3
What Is To Be Submitted.....	3
Real Estate Leases	4
Procedures.....	5
Accounting for Leases	5
Types of Reports	6
DOA Support	6
Preparation of Financial Statements Using LAS Reports.....	7
Internal Control.....	10
General.....	10
Records Retention.....	11
General.....	11
DOA Contact	11
Contact.....	11
Subject Cross References.....	11
References.....	11

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Overview

Introduction

This topic provides guidance in the proper accounting and reporting for all lease agreement transactions.

All lease agreement information is entered on prescribed input forms (See CAPP Topic No. 70605—*LAS Input Documents*,) and submitted to the Department of Accounts (DOA) Fixed Asset and Lease Accounting Unit for keying into the Lease Accounting System (LAS).

The Lease Accounting System (LAS) provides the necessary reports for all financial reporting and disclosure requirements promulgated by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB).

Proper accounting for lease agreements is important because this is the basis of GAAP financial statements which are reviewed by bond rating firms and impacts the Commonwealth's borrowing rates. Also, knowledge of lease payment obligations provides improved control over outstanding lease-related liabilities of each agency.

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Policy

Authoritative Guidelines	All agencies and institutions must follow guidelines established by FASB Statement No. 13, <i>Accounting for Leases</i> , and all subsequent amendments and interpretations and GASB Statement No. 13, <i>Accounting for Operating Leases with Scheduled Rent Increases</i> .
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Lease Transactions to be Submitted to DOA	Agencies shall submit all lease transactions to DOA for inclusion in the Lease Accounting System (LAS), except as indicated below.
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What Is <u>Not</u> To Be Submitted	<p>Lease agreements for</p> <ul style="list-style-type: none"> • property, plant and equipment having an estimated fair market value of less than \$500, • a lease term of less than one year, • or annual payments totaling less than \$500 <p><u>are not required</u> to be included in LAS.</p>
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However, these leases may be included to assist the agency in monitoring its leases in a centralized system.

What Is To Be Submitted	<p>Assets for leases having an estimated fair market value of less than \$5,000 are deemed operating leases.</p> <p>Leases for assets having an estimated fair market value of \$5,000 or more must be classified as either (1) operating or (2) capital and entered into LAS.</p>
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Continued on next page

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Policy, Continued

Real Estate Leases

Real Estate Leases should be approved by the Bureau of Real Property Management, Department of General Services, in accordance with its policies and procedures.

Assets associated with capital or operating leases are not required to be included in FAACS, but may be for control purposes if desired. These are entered into FAACS as controlled items:

Acquisition Method = L for Lease
Ownership Status = L for Lease
"Controlled" in the control indicator field

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Procedures

Accounting for Leases

RECORDING AND DISCLOSURE OF LEASED ASSETS

LAS provides agencies with a tool to classify and record lease information properly. From the lessee's standpoint, lease payments associated with operating leases are recorded as an expense of doing business. There is no long-term debt associated with an operating lease and the asset leased under an operating lease is not recorded as an asset on the balance sheet at year end.

Capital leases, on the other hand, are recorded as debt on financial statements. The payments (except for certain portions that are made for taxes, utilities, maintenance, insurance or any other executory costs) are recorded as retirement of debt and interest expense, and the asset is recorded on the balance sheet as an asset at year end. Relevant conditions for recording the lease as an operating lease or capital lease, as well as the method of disclosure in financial statements, are covered below.

Leases are classified as either operating or capital based on the results of the four tests outlined in FASB Statement No. 13. (See CAPP Topic No. 31215—*LAS Transactions*). The following procedures apply for entering lease information LAS.

Complete LAS input forms 1, 2 and 3. (See CAPP Topic No. 70610—*LAS Input Documents*.) The first three of the four tests may be conducted by the agency. These are:

- A. Does title pass?
- B. Is there a Bargain Purchase Option?
- C. Is the lease term equal to or greater than 75% of the remaining estimated useful economic life?

The fourth test, *D—Is the present value of the payment stream using the incremental borrowing rate, equal to or greater than 90% of the fair market value?*—requires a calculator that has present value capability. DOA LAS staff routinely applies the fourth test when entering the lease on LAS.

DOA sends copies of lease reports to the agencies when transactions have been input. Agencies should review these reports and verify their accuracy.

Continued on next page

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Procedures, Continued

Changes to LAS based on changes to actual leases should be submitted to DOA in a timely manner. Either LAS Form 1, 2, and 3 may be submitted. Also, a copy of the LAS report for the lease can be edited and submitted; revisions might be appropriate for extensions, renewals, early terminations, and any other change that occurs.

When leases are entered on LAS, required data includes a beginning date and a payment stream. The payment stream is comprised of a payment amount, amount of executory costs, a number of payments and the frequency of payments. For example, a lease might have 24 payments with one month between payments. In this case, the lease will run for two years.

The lease automatically terminates when the payment stream has run its course from the beginning date. At the end of each fiscal year, LAS is rolled over into the new fiscal year. Expired leases will not roll into the new fiscal year. If the lease is renewed, the agency should submit this information to DOA.

Expenditure and revenue activity for all leases must be processed through CARS as either rental expense or rental revenue, respectively.

LAS automatically provides for all appropriate accounting information, including classification of the lease as operating or capital.

Types of Reports

When using Report Request Form LAS-5, there are two report formats:

INPUT DATA = Discloses classification of the lease and provides agency with confirmation that a lease has been keyed and to allows agency to cross-verify data

FULL AND SUMMARY DISCLOSRE = Allows agencies to use in preparation of agency financial statements and are prepared at Fiscal Year End Close.

Reports with a suffix of **E** represent **lessee** leases; reports with a suffix of **R** represent **lessor** leases.

Input Data Reports are LEASR-01 FOR BOTH Operating and Capital leases.

Full and Summary Disclosure reports are LEASR-03 through LEASR-33 for both Operating and Capital.

DOA Support

DOA provides telephone assistance and training sessions when needed. Contact the Assistant Manager of Disbursements Review and Assistance for LAS questions or to arrange LAS training.

Continued on next page

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Procedures, Continued

Preparation of Financial Statements Using LAS Reports

To prepare financial statements, agencies with lessee leases should use the following procedures:

Operating Leases

No balance sheet accounts are presented as no asset nor obligation is recognized. The Statement of Revenues, Expenditures and Changes in Fund Balance (governmental fund types) or Statement of Revenues, Expenses, and changes in Retained Earnings/Fund Balance (proprietary fund types) present program expenditures that include rental expenditures. These amounts should be included in expenditure figures charged through CARS and summarized functionally in CARS expenditure reports.

Use the LEASR-26E report to prepare the operating lease footnote disclosure for future minimum rental payments. LEASR-27E provides the operating lease footnote disclosure for rental expense. *FASB Statement No. 13* requires rental expense on operating leases to be disclosed on a straight-line basis (i.e., evenly over the life of the lease) and not over the contract terms. GASB Statement No. 13 requires rent expense on operating leases with scheduled rent increases to be accounted for using the lease contract terms. The provisions of GASB 13 need not be applied to immaterial items. LAS uses proprietary software developed to meet FASB 13 requirements and therefore the roll up report (LEASR-27E) calculates rent on a straight-line basis. To obtain rent based on the contract terms, sum the rent expense on all individual lease reports. To determine if the difference is material on a lease-by-lease basis or a consolidated basis, review the LEASR-12E and LEASR-26E reports, respectively. The column entitled "Lease Payments Greater Than/(Less Than) Straight Line Rent" shows the difference. If the difference is not material, use the amount in the roll up report. If deemed material, then disclose rent expense by summing all the individual lease reports.

Capital Leases

Both assets and obligations should be presented in the agency balance sheet. For governmental fund types, these should be shown in the General Fixed Assets Account Group (asset) and the General Long Term Debt Account Group (obligation). For non-governmental fund types, presentation will be in the relevant fund.

Continued on next page

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Procedures, Continued

Refer to the LEASR-21E and 22E reports for the roll-up of Balance Sheet General Ledger Accounts. For most agencies, presentation will be in only either the General Fixed Assets and Long-term Debt Account Groups (governmental fund types), one of the proprietary fund types (internal service or enterprise) or the higher education fund. Accordingly, a single set of agency-wide roll up reports will suffice for presentation.

Where an agency requires presentation in more than one of the fund columns for balance sheet presentation, roll-ups by Division (used for fund) may be provided. If any are needed and not furnished, request them from the Assistant Manager, Disbursements Review and Assistance.

Show assets by category. **General Fixed Assets Account Group** is used to record governmental fixed assets, accumulated depreciation is not currently presented. The leased property column for the current fiscal year from the LEASR-21E report as broken down by category, gives the proper amount for presentation. The total leased assets should be offset in the Investment in General Fixed Asset Account. These amounts will be combined with other assets, owned by the agency, by category.

Proprietary Fund Types leased asset and accumulated depreciation amounts should be presented. Presentation of Higher Education Fund depreciation is determined by the institution.

Obligations, current and non-current from the LEASR-21E report for the current fiscal year, is presented in either the **General Long-Term Debt Account Group** (governmental fund types) or the **relevant fund** (proprietary or higher education) offset by the amount to be provided for retirement of the long term debt account.

Continued on next page

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Procedures, Continued

A **footnote disclosure** must be made of future lease payments on capital leases. Refer to the LEASR-22E report for the information needed for this disclosure. Please note that the bottom line of this disclosure; i.e., the present value of future minimum lease payments, should equal the total (current and non-current) obligation.

Since assets under capital leases will be included in the balance sheet by category with owned assets, a footnote disclosure for only leased assets (capital leases) using the LEASR-21E and 22E should be prepared.

The **Statement of Revenues, Expenditures and Changes in Fund Balance**, for governmental fund types and the Statement of Revenues, Expenses, and Changes in Retained Earnings/Fund Balance, for proprietary fund types, should theoretically include interest expense and depreciation expense rather than rental expense. The difference between interest expense and rental expense reduces the obligation for the period. In practice, for governmental fund types, presentation of expenditures per CARS, summarized functionally will suffice.

For **proprietary fund types**, however, adjustments should be made to properly classify expenses. Refer to the LEASR-27E report, Capital Lease Journal Adjustments, for information needed.

When a lease payment is made at the beginning of the period (usually month) rather than the end, some accrual of interest expense may occur. In the LEASR-21E report, any accrued interest expense is included in the current obligation amount. Refer to the LEASR-33E to see this broken out. The LEASR-14E report presents the accrued interest expense separately on each individual lease. On this report, present value of minimum lease payments does not include accrued interest.

Footnote disclosures in which changes in capital lease assets and obligations are included should be prepared. Refer to the LEASR-31E report. This report presents additions, retirements, and ending balance for assets. To obtain beginning balance for assets, refer to the balance for prior fiscal year end for assets on the LEASR-21E.

Continued on next page

Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Procedures, Continued

For obligations, start with the balance for the Prior Fiscal Year End for the total of both current and long-term obligations on the LEASR-21E, then add additions per the LEASR-31E*. The difference between the sum of the beginning balance and additions and the ending balance (total of current and long-term) may be considered terminations, expirations, etc.

* Additions for gross assets and obligations at inception date is the same.

When information for capital leases has been received and input in a fiscal year subsequent to that in which the lease began, the beginning balances for that year will most likely differ from the ending balances presented for the prior year. Agencies may need to reconcile ending balances to succeeding years computed beginning balances. If material in amount, a prior period adjustment may be required.

Internal Control

General

Each agency and institution should implement cost beneficial internal control procedures to ensure that:

- All leases are properly classified and included in LAS.
 - All rental expense and income transactions are posted in CARS.
 - Assets included in LAS which are also included in FAACS are properly coded to eliminate duplicate reporting.
 - Rent expense is reviewed and reconciled for proper disclosure.
 - Familiarity with the FASB and GASB statements is maintained and compliance with the Comptrollers Directive on Financial Statement Preparation is effected.
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Volume No. 1—Policies and Procedures	TOPIC NO	31220
Function No. 30000—Fixed Asset Accounting	TOPIC	LAS Reporting
Section No. 31200—Lease Accounting	DATE	December 2001

Records Retention

General


Records should be maintained for a period of at least three years or longer, if necessary, to be in compliance with policies established by the Records Management Section, The Library of Virginia. The retention period generally starts at the close of the fiscal period.

For pending, ongoing or unresolved litigation, audits or claims, retain documentation until completion, resolution or negotiation of settlements and retain according to standard schedules. Provide for the periodic destruction of records not subject to permanent deposit in accordance with policies and procedures established by the Records Management Section, Virginia State Library and Archives.


DOA Contact

Contact

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Subject Cross References

References

CAPP Topic No. 31215—*LAS Transactions*

CAPP Topic No. 70605—*LAS Input Documents*